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Enabling poor rural people  
to overcome poverty

## **IFAD's Engagement with Middle-Income Countries**

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For: **Review**

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## IFAD's engagement with Middle-Income Countries

### A. Introduction

1. The fourth session of the Consultation on the Eighth Replenishment of IFAD's Resources (October 2008) discussed the paper "IFAD's role in middle-income countries", and Members' conclusions are reflected in the Replenishment report: "The Consultation recognized that the needs of MICs are varied, and are changing, and that to remain effective IFAD needs to better fulfil its mandate by improving the service that it offers them, ensuring that its engagement with them is relevant, and enhancing the partnerships that these are built on."<sup>1</sup> The Consultation agreed that IFAD should:
  - Promote South-South cooperation more actively, including supporting MICs in their efforts to encourage knowledge-sharing and innovation in other Member States;
  - Identify the practices and procedures of other international financial institutions (IFIs) related to the application of lending terms and conditions to MICs that may be relevant for IFAD;
  - Establish voluntary modalities and instruments to enable countries that decide to reduce or cease sovereign borrowing from IFAD to continue to access the Fund's services – including knowledge and learning products and, if demanded, reimbursable technical assistance. In this regard, the Consultation agreed: "IFAD will develop a graduation policy consistent with the voluntary practice of other IFIs. It will furnish a framework with objective and transparent criteria that provides for consideration of the interests and wishes of borrowing countries that reach a graduation point."
2. This paper addresses these issues and other topics<sup>2</sup> that have become important in determining how IFAD partners with MICs.

### B. MICs in IFAD: A partnership for rural poverty alleviation

3. As is the case in other IFIs, the MIC membership of IFAD represents a large and varied group of countries. Recent policy papers prepared by the World Bank,<sup>3</sup> the African Development Bank<sup>4</sup> and the Asian Development Bank<sup>5</sup> have begun to address these issues. Responses thus far share a number of features that will have a bearing on IFAD's approach:
  - There is a consensus that the IFIs should continue to be involved in this group of countries, given the high levels of residual poverty;
  - To remain relevant in these countries, the IFIs must set interest rates at levels comparable with finance from other sources, provide a range of financial products, and streamline their lending conditions and procedures to reduce transaction costs;

<sup>1</sup> The Report of the Consultation on the Eighth Replenishment of IFAD's Resources (GC 32/L.5), submitted to the thirty-second session of the Governing Council, 18-19 February 2009, is included as an annex to this document.

<sup>2</sup> For example, all Member States are being affected by climate change, and MICs have experience of climate change adaptation and mitigation that could be relevant to other Members. IFAD can help transfer this, and other, knowledge to low-income countries and MICs as initiated under the IFAD Climate Change Strategy (approved by the Executive Board in April 2010) and the forthcoming (2011) environment and natural resource management policy.

<sup>3</sup> Development Results in Middle-income Countries: An Evaluation of the World Bank's Support. Independent Evaluation Group. 2007.

<sup>4</sup> The African Development Bank recognizes 13 of its members as MICs, but also acknowledges that, despite their status as MICs, they face many of the same problems that low-income countries face, namely slow growth and high unemployment, vulnerability to external shocks and slow integration into the global economy. Because of this, attainment of the Millennium Development Goals in these countries is "endangered".

<sup>5</sup> Enhancing Asian Development Bank Support to Middle-income Countries and Borrowers from Ordinary Capital Resources: First Progress Report. January 2008.

- For many of these countries, given their access to financial resources, the IFIs add value through their global and regional knowledge, and there is a broad consensus on the need to invest in deepening this knowledge and disseminating it more effectively; and
  - While there may be a limited role for stand-alone provision of knowledge services, these are seen as most effective when combined with financing.
4. All IFIs, including IFAD, use GDP/capita parameters to define MIC eligibility, and on this basis the World Bank has established a heterogeneous list of lower- and upper-MIC countries with GDP/capita income levels ranging from US\$996 to US\$12,195. Of these, 89 are IFAD Members. These countries are extremely diverse in terms of levels of income and overall development, especially human capital development. They include lower-middle-income countries with per capita GNI below US\$2,500 (e.g. Egypt and Syrian Arab Republic) to higher-middle-income countries with per capita GNI above US\$6,000 (e.g. Lebanon, Turkey). A review of MICs undertaken for this paper suggests that the MIC typology versus other low-income country typologies has limited use for IFAD since the rural characteristics of lower-income MICs are very similar to other low-income countries and their demands from IFAD are similar. What differs is that as MIC per capita income increases, they are better able to cofinance their own rural development programmes.
  5. Other IFIs use GDP/capita to define their MIC membership as those members not eligible for concessionary financing. In IFAD, MICs are defined as those countries not eligible for borrowing on highly concessional terms and whose income levels put them in the category of IFAD borrowers on intermediate and ordinary terms. In the 2004-2009 period, IFAD financed 28 new programmes in MICs across all regions for a total commitment of US\$636 million (see table).<sup>6</sup> The large variation in GDP/capita across the MICs suggests similar variations in poverty levels. Available data show that many MICs have extensive poverty in rural areas. Recent studies<sup>7</sup> estimate that the percentage of global poverty in the MICs (minus China and India) has risen from 7 to 22 per cent between 1990 and 2007/2008.

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<sup>6</sup> This also exemplifies IFAD's capacity to plan (with Member Governments) programmes specific to MICs, implement these programmes efficiently, and monitor and report on results.

<sup>7</sup> A. Sumner, "Global Poverty and the New Bottom Billion: What if Three-Quarters of the World's Poor Live in Middle-Income countries?", Institute of Development Studies, University of Sussex, September 2010.

**IFAD financing to MICs (2004-2009): Intermediate and ordinary terms**  
(thousands of US dollars)

<i>Country</i>	<i>GNI/capita</i>	<i>Lending on intermediate terms</i>	<i>Lending on ordinary terms</i>	<i>Total</i>
Gabon	7 370		6 000	6 000
Mauritius	7 240		6 001	6 001
Swaziland	2 350	5 998		5 998
China	3 590	62 345		62 345
Philippines	1 790	15 900		15 900
Argentina	7 570		39 341	39 341
Belize	8 071		3 000	3 000
Brazil	8 040		98 655	98 655
Colombia	4 930	20 000		20 000
Costa Rica	6 230		9 189	9 189
Dominican Republic	4 510		13 800	13 800
Ecuador	3 920		12 787	12 787
El Salvador	3 370		30 559	30 559
Guatemala	2 620	17 000	18 423	35 423
Mexico	8 920		29 973	29 973
Panama	6 710		4 200	4 200
Paraguay	2 270	3 100		3 100
Peru	4 150		23 037	23 037
Venezuela (Bolivarian Republic of)	10 150		13 000	13 000
Albania	3 950	9 600		9 600
Bosnia and Herzegovina	4 700	11 113		11 113
Egypt	2 070	64 134		64 134
Georgia	2 530	8 700		8 700
Jordan	3 740	11 777		11 777
Lebanon	7 970		4 605	4 605
Morocco	2 790	34 963		34 963
Tunisia	3 720		15 490	15 490
Turkey	8 730		43 300	43 300
<b>Total (28)</b>		<b>264 630</b>	<b>371 360</b>	<b>635 990</b>

6. IFAD's mandate to address rural poverty therefore remains relevant to the MICs. For example, in the developing economies of the Near East and North Africa region, large regional discrepancies and geographic pockets of poverty still exist, especially in the rural and mountainous areas. This was highlighted in IFAD's 2006 country strategic opportunities programme (COSOP) for Turkey, for instance: "According to the 2001 human development index (HDI) classification of Turkey's 80 provinces, 16 of the 20 least-developed provinces were located in either the eastern or south-eastern regions, and the remaining four in the Black Sea region. The average per capita GDP of the eight poorest provinces, all located in the east or south-east, was less than 30% of the national average. All other socio-economic indicators of development are also much lower in the eastern and south-eastern region of the country."<sup>8</sup>
7. In Latin America and the Caribbean (LAC), collective economic growth of countries was about 4.7 per cent per annum overall in the past ten years, reaching an average GNI per capita of US\$4,467. Yet, while many of the region's countries are moving towards the higher end of the middle-income spectrum, economic and social

<sup>8</sup> As a result, all current IFAD operations in Turkey are located in the eastern region.

inequities remain acute, with LAC's overall Gini coefficient above 0.53, the highest among the world's regions (i.e. suggesting the least-equitable income distribution). In the Bolivarian Republic of Venezuela, about 11 per cent of the population live in rural areas, where more than 50 per cent of the population are poor.<sup>9</sup>

8. India and China still have the largest rural poor populations in the world. In Indonesia, 50 per cent of the total households remain clustered around the national poverty line, and 70 per cent of the poor live in rural areas. Moreover, the poverty gap index indicates that, although the proportion of Indonesia's people living in poverty has fallen to almost the pre-1997-crisis level, those who are poor now are worse off than before, especially in eastern Indonesia.
9. IFAD's business model has demonstrated its effectiveness in the MICs, with satisfactory development impact in over 80 per cent of IFAD-supported projects and programmes in these countries.<sup>10</sup> In addition, all country programme evaluations undertaken by the IFAD Office of Evaluation in MICs – including those undertaken recently for Argentina, Brazil, India and the Philippines – have found IFAD's performance satisfactory.
10. As reflected in recent client surveys, IFAD is seen by most Governments as being open to their views and suggestions. It is seen as a membership organization providing assistance to its Members, including MICs, rather than as a donor organization. The MICs themselves see value added in IFAD's efforts to help them address rural poverty, particularly given its experience in assisting rural poor communities in establishing viable farm and rural enterprises. IFAD is also seen as willing to support programmes in difficult regions or areas, or in post-conflict situations. This is not an exclusive MIC issue but highlights IFAD's responsiveness to its Members' needs. What differs in MICs as a group, compared with other low-income countries, is the ability to self-finance rural development. Other differences are largely differences among countries (China needs a different programme from Swaziland though both are MICs).

### **C. Strategic considerations for the engagement with MICs**

11. Given the wide variety of country-level needs and conditions in MICs, a single all encompassing "policy" that attempts to set specific parameters would not be effective or efficient. Instead, the diversity of MIC requirements and the need for IFAD to have the flexibility to respond to these country (and specific regional) issues require an approach tailored to each MIC, and defined in a country strategy (COSOP). This allows, firstly, a better understanding and review of each country's needs and, secondly, a more precise set of interventions responsive to each country's situation. IFAD would treat MICs and other low-income countries in the same manner, customizing its partnership and support as defined in the country strategy and project design. IFAD's Strategic Framework and policies apply to MICs as well as other countries.
12. MICs in IFAD are structured as a financial "pivot" with several interfaces, which has implications for the IFAD financial model<sup>11</sup> in terms of loan reflows, loans and replenishment contributions:
  - Reflows from loans provided to MICs are projected to amount to US\$275 million in 2011-2012, and, increasingly, they provide replenishment contributions (US\$68 million in 2010-2012);
  - MICs are potential recipients of IFAD financial investments;
  - MICs provide national public resources to their own rural development programmes designed with the help of IFAD in cofinanced projects. By helping

<sup>9</sup> World Development Indicators, 2009, the World Bank.

<sup>10</sup> See the Annual Report on the Results and Impact of IFAD Operations (ARRI) 2007, table 15.

<sup>11</sup> The IFAD financial model is developed to project financial inflows/outflows and takes into account the lending, loan reflows and resources made available by MICs.

design these projects, IFAD is “steering” public resources to the rural sector (the target for domestic mobilization and cofinancing of MIC projects in 2010-2012 is US\$1 billion); and in line with PBAS allocations;

- MICs will be receiving financing from IFAD (projected lending in 2010-2012 is US\$500 million).

#### **D. Is there need to develop differentiated products and services for MICs?**

13. Most MICs acknowledge that what they are looking for from an IFAD loan project (over and above a competitive financial product) is IFAD’s knowledge of rural poverty dynamics, experience in project design methodology/approach, supervision tools, and/or policies related to the agriculture and rural sectors (e.g. targeting or rural financial services approaches, decentralized and participatory rural development, natural resource management, etc.). Many MICs also look to IFAD for innovative design and implementation modalities. None of this demand is unique to MICs however; low-income countries are increasingly looking for innovative financial and project solutions. IFAD will therefore increasingly differentiate its products according to country demands, in both MICs and other low-income countries.
14. Countries such as Brazil, Colombia, Mexico and the Bolivarian Republic of Venezuela, have already asked IFAD to integrate project and technical services, and knowledge products as well as financing into their rural development programmes.
15. In order for IFAD to offer the design and financing options that Member States want according to each country’s individual needs, IFAD will need to put in place more versatile funding instruments capable of balancing development outcomes and risks. All borrowing countries will be eligible to use these evolving instruments, although MICs are likely to be the most demanding customers. IFAD will need to adopt amended business processes, and provide a “menu” of lending and knowledge products that can interest its borrowing Members and non-borrowing MICs in widely different situations. IFAD will continue using existing lending and grant products within the agreed allocations, where appropriate, while also introducing new products, including support of private-sector initiatives. The Fund will also develop knowledge services such as reimbursable technical assistance, policy advice, analysis, partnership development and the facilitation of South-South cooperation, to all of its Members; however it is likely that MICs will be the quickest to apply.

#### **E. Differentiated services: Enhancing IFAD’s financial products and services**

16. IFAD’s MIC partners have requested that IFAD develop an appropriate range of financial products that are concomitant with its mandate of rural poverty reduction and which combine knowledge and technical services. Such products could include:
  - **Currency options**, possibly including single currency lending with a variable spread or fixed rate over the London interbank offered rate. An ongoing World Bank Treasury study indicates that, within IFAD’s existing asset liability management framework, there is the possibility of managing a single currency “pilot” programme in United States dollars up to US\$100 million, in 2011 and 2012.<sup>12</sup> MICs may be the first countries to apply, based on World Bank experience.
  - **Grace periods and maturities.** Governing Council approval to allow the Executive Board to introduce “hardened terms” in line with International Development Association practice, and the ongoing revisions to the IFAD

<sup>12</sup> Currently, IFAD lends in special drawing rights (SDRs) as a single currency of account, whereas the currency of payment is in a single currency as specified in the financing agreement. Several countries prefer to borrow in another currency (United States dollars, euros) both as a currency of account and as the currency of payment.

Lending Terms and Conditions<sup>13</sup> will provide an opportunity for the Executive Board to review and modify existing terms and conditions to align them more closely with those of other IFIs. Lower income MICs will benefit.

- **Alternative financial products**, including, possibly, equity investment and lending to private enterprises without sovereign guarantees will be investigated. These would be of interest to all List C IFAD Member States; MICs, however, are most likely to be the first users should such instruments be developed. Working within its current operational model and instruments, IFAD has been able to modify its loans into quasi-equity or refinancing facilities directed mostly at the private sector in both Central Europe and Africa. Following further analysis, including a comparative review of the products provided by other IFIs, IFAD could develop for all Members – MICs and highly concessional countries alike – for consideration by the Executive Board, financial instruments that allow the Fund to engage directly with the private sector (such as through equity funds that invest in private microfinance institutions, or through guarantees or direct lending) using non-replenishment sourced funds.
  - **External resources.** In line with the development of appropriate financial products, loans to Members could increasingly be financed (i) by IFAD’s mobilizing resources from outside its replenishment, (ii) from foundations, (iii) by borrowing from donors, (iv) from the market, and/or (v) by mobilizing more commercial resources. IFAD already provides substantial non-replenishment financing to its Members through direct cofinancing and supplementary financing. The recent financing provided by the European Commission- and World Bank-administered Global Agriculture and Food Security Program is an example.
17. Although MICs have been the most insistent about the development of these instruments, all IFAD borrowers would be eligible.

## **F. Differentiated services: Enhancing IFAD’s knowledge products and services**

18. IFAD already has some knowledge products of importance to MICs, which will be developed further:
- **Policy, “convening” and advocacy platforms.** IFAD contributes to its Members by sponsoring dialogue and brokering partnerships between diverse rural stakeholders and constituencies, both within and between countries. This can contribute to Governments’ own policy definition and investment of public resources in rural development and poverty reduction. Examples include (i) in LAC, the Central America Free Trade Agreement and the Common Market of the South’s Commission on Family Farming and its Confederation of Family Farmer Producer Organizations; and (ii) in Africa, the New Partnership for Africa’s Development (NEPAD) Comprehensive Africa Agriculture Development Programme. For non-borrowing MICs, these services could be provided for a fee.
  - **Support to developing national agricultural/rural development strategies.** MICs are increasingly requesting sustained analytical support in subsectoral or thematic areas (targeting, gender, rural financing, etc.). Support is delivered by IFAD on the basis of flexible, demand-driven programmes that focus on results. For example, in 2008, Egypt asked IFAD and the World Bank to help in the preparation of a new agricultural development strategy, to which both contributed. Similarly, Lebanon requested technical assistance for the pro-poor update of its agricultural

<sup>13</sup> A report on the revision of the Lending Policies and Criteria is being presented to the December 2010 Executive Board.



development strategy. In China, Indonesia and the Philippines, IFAD is supporting research into the effects of biofuel on agricultural development, food security and poverty, and its impact at the household level. These examples are also important as they have all been financed through IFAD's grant programme and highlight the benefits of relatively small, targeted grant assistance to MICs. In future, it will be possible to provide such assistance to MICs on a reimbursable basis. For example: Azerbaijan has expressed willingness to pay for IFAD's technical assistance in helping them design their new agricultural development strategy. Similarly, Algeria (which is currently not borrowing from IFAD) has also expressed interest in reimbursable technical assistance in the area of rural finance.

- **South-South cooperation.** IFAD can help transfer knowledge to local and regional institutions for greater learning. For example, in collaboration with existing institutions (universities, agricultural colleges, etc.), it could spread knowledge by facilitating learning routes, organizing study tours and employing experts from other Southern countries (for example, arranging for Turkish consultants to bring their knowledge and expertise of rural development in Turkey to Azerbaijan). IFAD will develop peer-to-peer collaboration and build local capacity. In East and Southern Africa, this type of work has included working with the private sector. MICs also have experience, particularly in Latin America, on climate adaptation and mitigation, e.g. agroforestry and payment for environmental services (linked to carbon markets), zero tillage (for soya) and the use of legumes for nitrogen enhancement. As other Member States develop their own initiatives, these experiences will become increasingly important. Examples are already appearing (e.g. Burkina Faso and the Niger recently reviewed approaches to soil and water conservation).

## **G. Enhanced country ownership and lowered transaction costs of borrowing from IFAD**

19. At the country level, several MICs (but not all) have well-functioning public systems of accounting, auditing, procurement and financial management. Use of these national systems to perform such functions in IFAD-financed projects is increasingly demanded by MIC borrowers, and is in line with the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action. These systems also offer the opportunity for South-South exchange. IFAD will facilitate this exchange to help develop similar systems in low-income countries.

## **H. Graduation**

20. In the broadest sense, within the policies and processes of IFIs, graduation refers to the progression of Member States through a series of financing terms until, either formally or informally, Members no longer seek to borrow from the IFI. Graduation in IFAD is currently applied through its Lending Policies and Criteria (in much the same way as the African Development Bank applies graduation through its credit policy) to advance its borrowing Members through the different lending terms, based on GNI per capita. As IFAD Members progress through the different lending terms, they eventually, voluntarily, stop borrowing. In this way, a number of List C Members have decided to stop borrowing from IFAD (Algeria) while others have stopped, and then requested to restart borrowing (Tunisia). Moreover, Algeria, Argentina, Chile, Colombia, Jordan, Malaysia, Thailand, Tunisia and Uruguay decided to stop borrowing in 2007-2009, and still subsequently contributed to IFAD's Eighth Replenishment.
21. In developing the options to refine the existing policy of progression through lending terms and the voluntary cessation of borrowing from IFAD, several perspectives are taken into account. First, confronting the looming fiscal constraints in the Organisation for Economic Co-operation and Development (OECD) will require

IFAD to focus replenishment-sourced resources on highly concessional poor countries, while supporting the use of MICs' own resources for rural poverty programmes. MICs can also increasingly be asked to reimburse IFAD for services such as knowledge transfer, project design and management. Several MICs have emphasized that they want access to all IFAD's services (including borrowing), more customized and differentiated projects, and more sophisticated financial instruments (single currency lending, variable interest rates and maturities) together with South-South cooperation facilitated and, in some cases, financed by IFAD. IFAD can focus its funding on low-income countries and lower-income MICs, while offering reimbursable services to upper-income MICs.

22. The graduation policy options to be considered by the Executive Board are:

**Option 1:** Maintain the existing graduation/progression mechanism (in line with the Agreement Establishing IFAD), including:

- MICs voluntarily cease borrowing at their own discretion;
- Non-borrowing MICs continue to be eligible for other IFAD services, some of which on a reimbursable basis, and are encouraged to provide replenishment resources to IFAD; and
- Borrowing MICs gradually receive lower allocations under IFAD's performance-based allocation (PBAS) system as per capita income increases.

**Option 2:** As above, but with the International Bank for Reconstruction and Development (IBRD) system of setting a per capita income level above which the graduation process is launched – currently at US\$6,885 for IBRD (1 July 2010);

- The process would include a joint IFAD-Government assessment of readiness to graduate, and of the pace and nature of continued partnership once the graduation threshold is reached. In some cases, lending could continue based on the support plan agreed with the Government and subject to approval by the Executive Board; and
- Development of services and differentiated products for higher-income MICs based on a reimbursable model.

**Option 3:** As for option 2 with, additionally:

- Continued identification and establishment of additional, non-replenishment financing sources, to be made available by IFAD to MICs (as well as other Members); and
- In the medium term, modification of the PBAS formula by increasing the influence of a lower GNI/capita<sup>14</sup> to favour poorer countries by raising the per capita allocations of those countries.

23. Management's preference is for option 3, which allows for continued servicing of all MIC needs, but increasingly on a reimbursable basis as a MIC's per capita income increases and with a more structured planning of graduation from IFAD borrowing.

## I. Strategy conclusions

24. In response to MIC needs, IFAD proposes to:

- (i) Develop a more customized (country-specific) and differentiated menu of country strategy and project interventions in response to all country client needs, but which are more likely to be taken up quickly by MICs;

<sup>14</sup> By increasing the negative exponent of GNI currently in the formula at -0.25 to -0.5, for example.

- (ii) Support the evolving research agenda on the nature and causes of rural poverty in MICs, quantitative and qualitative definitions of MICs, and issues on in-country income inequalities;
- (iii) Develop new lending instruments, possibly including single currency lending on a pilot basis for 2011 and 2012, and a wider range of non-concessional interest rates and maturities. IFAD's intermediate and ordinary loan terms for MICs should be adjusted in line with other IFI products;
- (iv) Develop existing and new financial sources to help finance interventions in all IFAD borrowing countries and South-South cooperation, which are likely to be taken up quickly by MICs but which will interest other low-income countries as well;
- (v) Deepen its intra-institutional knowledge-sharing as well as its internal knowledge creation and capture. IFAD would see knowledge transfer and capacity development (including South-South) as an integral part of its mandate, together with reimbursable technical assistance. A particular area for development would be MICs' experience in climate change adaptation and mitigation;
- (vi) Streamline its procedures for developing new country strategies and projects in countries with a strong track record of success in implementing IFAD-supported programmes. The emphasis should be on accentuating country ownership, as well as reducing IFAD transaction costs for all borrowers, although this is likely to interest MICs immediately; and
- (vii) Introduce one of the three "graduation" options for approval by IFAD's Governing Council, depending on the consensus position developed by the Executive Board. Management recommends option 3, described above.



## **IFAD's role in middle-income countries**

A report prepared for the consultation on the  
Eighth Replenishment of IFAD's Resources – Fourth Session  
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## **Abbreviations and acronyms**

ARRI	Annual Report on Results and Impact of IFAD Operations
IBRD	International Bank for Reconstruction and Development
IFIs	international financial institutions
MICs	middle-income countries

## **IFAD's role in middle-income countries**

### **I. Summary**

1. The Annual Report on Results and Impact of IFAD Operations (ARRI) for 2007 indicates that IFAD makes an important contribution to the efforts of many middle-income countries (MICs) to address rural poverty issues. In parallel, the rapid growth of many MICs in recent years and their increasing ability to access resources from the international capital markets has led the international financial institutions (IFIs) to take steps to ensure that their financial packages to these countries remain attractive. In addition, IFIs are adding value to MIC poverty reduction programmes by deepening the knowledge content of their initiatives. IFAD needs to undertake a similar adaptation given the continuing relevance of IFAD's support for rural poverty reduction and the continuing interest of MICs in having IFAD provide such support. IFAD, to enhance its contributions to MICs, needs to ensure that its lending terms are aligned with other IFIs, increase the efficiency of its operations and build its capacity to provide the knowledge and innovative programmes the MICs are looking for. This paper includes recommendations in these areas to enable IFAD to achieve its potential in contributing to rural poverty reduction in the MICs. Among them are a review of lending parameters, changes in operational procedures for programme design and implementation, the development of criteria to assess borrowing needs, and continued implementation of the IFAD knowledge management strategy to include features with specific relevance to MICs.

### **II. The evolving situation of the middle-income countries: implications for international development institutions**

2. One third of the world's poor people live in MICs, most of them in rural areas. According to the 2005 World Development Indicators published by the World Bank,<sup>1</sup> 94 countries fall into the middle-income range, 77 of whom are IFAD Members. Those at the top end of the range, the upper middle-income countries (e.g. Mexico, with US\$7,310 per capita) have per capita incomes five or six times higher than those at the low end of the range, the lower middle-income countries (e.g. Sri Lanka: US\$1,160 per capita).
3. The past decade has seen rapid growth rates in many MICs. This, combined with increased availability of the skills, experience and competence needed to manage their economies, has enhanced their ability to raise financial resources from the international capital markets at rates comparable to those available from the IFIs.
4. The evolution of MICs has led international development institutions to clarify and sharpen their strategies for supporting them. Recent policy papers prepared by the World Bank,<sup>2</sup> the African Development Bank<sup>3</sup> and the Asian Development Bank<sup>4</sup> have begun to address these issues. Responses thus far share a number of features that will have a bearing on IFAD's approach:

<sup>1</sup> For the purposes of the technical discussion in this paper, MICs are defined as the 57 Member States eligible to borrow from IFAD on intermediate or ordinary terms. (The remaining 20 Member States that are designated by the World Development Indicators as MICs are all lower middle-income countries and remain eligible for IFAD highly concessional loans).

<sup>2</sup> Development Results in Middle-income Countries: An Evaluation of the World Bank's Support. Independent Evaluation Group (IEG). 2007.

<sup>3</sup> The African Development Bank strategic framework for support to MICs is currently under preparation.

<sup>4</sup> Enhancing Asian Development Bank Support to Middle-income Countries and Borrowers from Ordinary Capital Resources: First Progress Report. January 2008.

- There is a consensus that the IFIs should continue to be involved in this group of countries, given the high levels of residual poverty;
  - To remain relevant in these countries, the IFIs must set interest rates at levels comparable to finance from other sources, provide a range of financial products, and streamline their lending conditions and procedures to reduce transaction costs;
  - For many of these countries, given their access to financial resources, the IFIs add value through their global and regional knowledge, and there is a broad consensus on the need to invest in deepening this knowledge and disseminating it more effectively; and
  - While there may be a limited role for stand-alone provision of knowledge services, these are seen as most effective when combined with financing.
5. From the perspective of both its membership base and its place in the development architecture, IFAD needs to adapt to the evolving situation of MICs. This has been recognized by the Accra Agenda for Action, which endorsed the need to adapt the commitments agreed at Accra to different country circumstances, including in MICs.<sup>5</sup> **The purpose of this paper is therefore to establish the platform for IFAD, in line with what other IFIs are doing, to explore ways to lower its financial and transaction costs, and to deepen its knowledge content and capacity to support rural poverty reduction in the rapidly evolving situation in MIC Member States.**

### III. IFAD's mandate for engagement with middle-income countries

6. The Agreement Establishing IFAD, the Lending Policies and Criteria and the IFAD Strategic Framework 2007-2010 all confirm that IFAD's mandate to address rural poverty is highly relevant to MICs. Although these countries overall have sustained a high rate of growth, there are still large numbers of poor people in rural areas.

#### Box 1: Rural poverty in Brazil

Brazil's per capita income of US\$3,550 in 2005 (based on the World Bank World Development Indicators) places it within the upper middle income category. Yet, as noted in the country strategic opportunities programme (reviewed by IFAD's Executive Board on 11 September 2008), there is a need to break "the vicious cycle of poverty that is perpetuated by the lack of sustainable sources of income and employment for the rural poor." Family agriculture is important in Brazil. It accounts for 85 per cent of farms, 30 per cent of the farming area, 38 per cent of agricultural output and 50 per cent of agricultural investment and employs 14 million people on more than four million farms. Poverty is widespread in the country and, in spite of recent progress, the levels remain high, particularly in the rural areas and in the north-east, which has the highest incidence of poverty. In 2004, 7.5 per cent of the total population were earning less than a dollar a day, and those earning less than two dollars a day accounted for 21.2 per cent of the total population. The main problems facing small farmers are limited access to agricultural resources such as arable land and other assets; poor infrastructure; inadequate support services; institutional and organizational deficiencies; and little or no education, which limits the farmers' ability to innovate. The farmers find it hard to enter dynamic markets owing to their difficulty in providing reliable supplies of standard-quality produce in bulk. IFAD's approved programme in Brazil has therefore systematically targeted small farmers and addressed the constraints they face. However the country programme evaluation noted limited results in knowledge management, policy dialogue and the scaling up of successful project innovations. Experience gained under the Afro-Latino programme, FIDAFRIQUE and FIDAMERICA; Knowledge Networking for Rural Development in Asia/Pacific Region (ENRAP) and the Programme for Strengthening the Regional Capacity for Monitoring and Evaluation of Rural Poverty Alleviation Projects in Latin American and the Caribbean (PREVAL) are expected to help build capacity among IFAD project staff to assess and systematize innovative methods of dealing with rural poverty. Information on IFAD experience in Brazil will be disseminated by means of newsletters, brochures, Internet-based media, IFAD's website and the Rural Poverty Portal to ensure that relevant material is shared with IFAD-supported projects and programmes worldwide. The proposed projects for 2009 – the Piauí and Paraíba semi-arid projects – will both include productive development approaches and support for the generation and dissemination of knowledge relevant to semi-arid areas with outcome indicators to monitor this. As part of the overall "package" approach to this middle-income country, a grant will be extended to facilitate policy dialogue on smallholder agriculture at the national and international levels among Common Market of the South countries (MERCOSUR) and within the context of overall South-South cooperation.

<sup>5</sup> Accra Agenda for Action, Looking Forward, paragraph 28. Accra, 4 September 2008.



7. In many cases the rural poor are concentrated regionally or ethnically and have benefited little from increasing wealth in rapidly growing urban centres (see box 1 above). In some cases, the widening gap between the rural poor and the urban population has been a source of civil unrest that poses a threat to society at large.
8. **The country-level rationale.** At the level of country operations, MICs themselves see considerable value added in IFAD's efforts to help them address rural poverty. A number of factors are at work here. First, IFAD is perceived as open to governments' views and suggestions, and able to respond in a flexible manner. This enables IFAD to support innovative pilot programmes with a view to developing approaches that can be scaled up by the Government or other donors. Second, rural development is an area to which governments attach increasing weight (especially with recent food price increases) but often feel unable to come up with workable programmes. Drawing on its operational experience from across the developing world, IFAD can help design successful programmes in rural areas, such as supporting capacity development for local and community-based organizations, including civil society organizations; establishing effective water management systems; facilitating access to rural financial services; increasing productivity in farm and non-farm activities; and promoting gender equality and women's empowerment. Third, IFAD is prepared to support programmes in difficult and dangerous areas where there is a perception that "no one else is willing to go". Fourth, IFAD's business model has demonstrated its effectiveness in MICs with satisfactory development impact in over 80 per cent of IFAD-supported projects and programmes.<sup>6</sup> The proposed support for Mauritius (see box 2 below) exemplifies many of these aspects of IFAD's value-added for MICs.

**Box 2: Tackling rural unemployment in Mauritius**

In the Mauritius Marine and Agricultural Resources Support Programme, IFAD has helped the Government of Mauritius assemble a package of activities and financing to address key rural development issues. The programme has been developed over the past two years to deal with the economic impact of phasing out sugar and textile preferences and rising fuel prices. The sugar problem alone has left 6,500 rural workers unemployed. There is no easy solution to these problems. IFAD is working with the Government to develop selective employment schemes in the context of a medium-term expenditure framework to diversify agriculture away from sugar, producing quality food products for the tourism sector, which is highly dependent upon imports. In addition, the programme is looking at sustainable fisheries development, including protection of coral reefs and selective fish farming activities in lagoons. IFAD is providing financing on ordinary terms for its US\$6 million loan, but the Government of Mauritius has made this contingent on IFAD bringing its interest rate in line with current International Bank for Reconstruction and Development rates. IFAD is also cofinancing the project with US\$400,000 of grant money, and has secured agreement for a grant of US\$700,000 under the Global Environment Facility/United Nations Development Programme small grants facility, and a grant from the Western Australian government of US\$375,000 for the fisheries component.

9. **The capacity to transfer knowledge worldwide.** A key feature of IFAD's work in MICs is generating knowledge to transfer to other developing countries, including on innovative approaches. Such knowledge transfer is a two-way process that enriches both MICs and low-income countries. Most of IFAD's lending to the Latin America region, including its loans in recent years to Argentina, Brazil, Colombia, El Salvador, Guatemala, Mexico, Panama, Peru, Uruguay and the Bolivarian Republic of Venezuela, has been on ordinary terms. In addition to intraregional knowledge transfer, IFAD has the capacity for interregional knowledge transfer, to emerging MICs and to other Member States. IFAD's capacity to acquire and transfer knowledge worldwide, including to lower-income countries, is thus related in part to its engagement through non-concessional lending to MICs.

<sup>6</sup> Annual Report on Results and Impact of IFAD Operations (ARRI) 2007, table 15.

10. **The case for a change in approach.** As with other IFIs, IFAD needs to enhance its products in a number of ways:
- More competitive financial products. While IFAD has adjusted its interest rates in line with other IFIs, it offers its borrowers a single loan product with fixed grace periods, maturities and currencies that do not necessarily reflect the increasing sophistication of asset-liability management by MIC governments.
  - There is the need and the potential in MICs, as in other countries, to enhance effectiveness.
  - Greater IFAD country presence in MICs. This would translate into better country knowledge, as well as a closer and more continuous client relationship as a platform for business development.
  - More systematic retrieval and management of IFAD's substantial project experience to create an institution-wide knowledge resource. MICs are seeking a transfer of global and regional knowledge from IFIs and would welcome it in the difficult areas that IFAD focuses on. A recent assessment of IFAD's response to the 2005 independent external evaluation identified knowledge management as an area where further progress could be made under the Action Plan.<sup>7</sup>

#### **IV. Availability of IFAD resources for middle-income countries**

11. IFAD was established as a member-based institution to assist all developing Member States in addressing rural poverty issues. Over time it has served clients across the full spectrum of countries, from the poorest fragile states to upper middle-income countries. IFAD's mandate recognizes that it has a group of borrowers with income levels too high to warrant full concessionality but rural poverty issues that merit continued involvement. Thus it encompasses progression from highly concessional to intermediate to non-concessional terms as per capita incomes evolve. This forms the basis of practices at other IFIs such as the World Bank (see box 3). While IFAD's approach is not as formalized as that of the World Bank, it is current practice that high-income MICs do not receive loans. For the last 10 years, all Member States receiving IFAD intermediate or ordinary loans have continued to be eligible to receive either International Development Association (including blended) or International Bank for Reconstruction and Development (IBRD) terms from the World Bank.
12. Consideration should be given to the question of whether this progression from highly concessional through intermediate to ordinary terms should take place, as is the practice at IBRD (see box 3). The IBRD model does not have a single cut-off, but rather a threshold to initiate a discussion with the country concerned. It is noted that no country currently borrowing from IFAD would be affected by IBRD practice.

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<sup>7</sup> Assessment of IFAD's Action Plan: Draft Report, pages 42 and 43. Freeman and Bie. 14 June 2008.

**Box 3: Graduation practice of IBRD**

According to IBRD policy, graduation reflects the achievements of a country in reaching a certain level of development, management capacity and access to capital markets. The policy also states that graduation from IBRD borrowing does not imply that the development process is complete. When a country reaches a GNP per capita benchmark, IBRD analyses its readiness for graduation based on access to capital markets and progress in establishing economic and social institutions. The current per capita income level for initiating the IBRD graduation process is US\$6,465 (effective 1 July 2008). Attainment of the per capita income level generally triggers a review of the country's development situation, including access to external capital markets on reasonable terms, and the extent of progress on establishing key institutions for economic and social development. Under such guidelines, Mexico, with a per capita income of US\$7,890, is still borrowing from IBRD.

IBRD takes a flexible approach to determining the pace of graduation. Graduation from new IBRD lending normally occurs within five years after a country crosses the graduation threshold. Over the past 10 years several countries have graduated from IBRD, most recently the Czech Republic and Slovenia, neither of which borrow from IFAD. IBRD graduates continue to be eligible for International Finance Corporation operations for a number of years.

## V. Adapting IFAD's approach to middle-income countries

13. **There is clear evidence<sup>8</sup> that IFAD makes a useful contribution to the efforts of many middle-income countries to address rural poverty issues.** IFAD's basic business model is well adapted to the interests of MICs, providing for genuine partnership in developing programmes, ownership of projects on the part of MIC governments, and IFAD participation in pilot or innovative projects that governments might find difficult to undertake without IFAD involvement. Clearly, the situation is evolving and MICs are looking for additional services from IFAD. In particular, they want IFAD to provide somewhat more varied and efficient financial products, deeper knowledge content and more effective knowledge brokering, and greater support for innovation.
14. IFAD's strength lies in providing a package of services led by its loan and grant products and putting together a coalition of government, international partners, and civil society to support specific programmes for rural poverty reduction. MIC governments continue to want these services, but as part of the package. There may be very special situations where reimbursable activities are feasible, but the experience of other IFIs suggests that no ready market exists to develop a business product along these lines.<sup>9</sup> There is a role, however, for collaborative programmes of the kind described in Thailand (see box 4), where IFAD can leverage in-kind contributions by its MIC members to benefit of its knowledge services more broadly. Moreover, IFAD would continue to monitor the experiences of other IFIs on this issue and draw on those lessons.

## VI. Enhancing IFAD's financial products and services

15. **Current lending levels.** IFAD currently lends up to 20 per cent of its total commitments to MICs during a replenishment period, in line with the commitment to lend the majority of its resources on concessional terms. The frequency of loans to MICs is about one per replenishment period to the 7 or 8 larger MICs and one per two replenishments for the 10 to 12 smaller ones (see table below). This is not dissimilar to MIC lending levels by the other IFIs engaged in agriculture and rural development.

<sup>8</sup> ARRI 2007, table 15.

<sup>9</sup> While the World Bank has a reimbursable technical assistance programme for Saudi Arabia and provides technical expertise in areas such as telecoms privatization, countries' willingness to pay for such services has generally been limited to covering costs of their own staff as in Thailand, contributing to joint analytic work with the World Bank.

**IFAD loans to MICs (2004-2006)**

	<i>Current US\$ million</i>	<i>Percentage</i>
All IFAD loans	1416.3	100
IFAD loans to MICs:	254.7	18
At intermediate terms	81.1	6
At ordinary terms	173.6	12

16. There are four areas in which IFAD needs to consider enhancing its financial products for MICs:
- a. **Maintaining ordinary lending rates comparable to those of other IFIs.** Of the 48 IFAD Members that qualify for ordinary terms, 18 had current portfolios as of mid-2008. Most of these portfolios reflected borrowing when the countries concerned were eligible for intermediate or highly concessional terms, before they progressed to ordinary terms. Obviously, rapid growth in MIC incomes has and will continue to move an increasing number of MICs into less concessional rates and maturities. Argentina, Brazil, El Salvador, Mexico, Tunisia and Turkey, for example, all borrowed from IFAD on ordinary terms during the Sixth Replenishment period. Aligning and adjusting terms with other IFIs (in line with current practice) remain an important feature of IFAD's approach to MICs.
  - b. **Providing middle-income countries with a wider range of financial products.** This would include the review of potential changes in grace periods and maturities, and alternative financial products (i.e. alternatives to IFAD's long-term loans and grants denominated in special drawing rights). Changes in grace periods and maturities are possible within the established lending procedures and can be factored into IFAD's financial projections. The current three-year grace period for ordinary terms, which takes effect upon loan effectiveness, is an area where greater flexibility could be of benefit to borrowers, and IFAD could consider introducing the option of five-year grace periods (as currently applied to intermediate loans) for innovative projects (which often require considerable lead time to get under way) financed by ordinary term loans. The shorter grace period could be retained for projects that are essentially follow-up operations, e.g. expanding an area development programme into a new region. Similarly, IFAD could consider the range of maturity options that the IBRD currently offers its borrowers. In the medium term, IFAD could consider alternative financial products such as the dedicated facility to handle operations with the private sector (as noted in the paper IFAD's Response to the Emerging Role of the Private Sector [REPL.VIII/4/R.6]), which should be particularly attractive within MICs, rather than, at this stage, providing alternative currency options to the special drawing right.
  - c. **Lowering the transaction costs of borrowing from IFAD.** The transaction costs of loan preparation and implementation require further review but could be lowered, as far as procurement and financial management during implementation is concerned, if IFIs make greater use of the national systems of MICs (therefore supporting the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action). IFAD may want to look specifically at these options in its country strategic opportunities programmes (COSOPs) and project design in MICs.<sup>10</sup> Processes could be streamlined for projects involving replication. In particular, the requirement to evaluate projects prior to financing a second phase is an area where significant cost and time savings could be achieved through selective rather than general application (e.g. unless supervision indicates fully satisfactory performance during the first

<sup>10</sup> Because IFAD is operating in rural areas often with procurement carried out through multiple small contracts, a move to the use of country systems may be much less controversial than in the case of other IFIs.

phase). Nevertheless, it is important to note that IFAD is operating in a particularly difficult area and that most of the IFIs spend a great deal of time preparing projects designed to tackle rural poverty. IFAD in particular focuses on participatory processes and the involvement of local stakeholders in design and implementation.

- d. **Reducing the costs of preparing IFAD country strategies in middle-income countries with small programmes.** Results-based COSOPs are designed for and are appropriate for countries with an extensive existing and planned IFAD portfolio. For most MICs with perhaps only one project during an allocation period, a shorter document, focusing on the particular rural poverty situation in the MIC and defining an IFAD strategy, programme (including knowledge products) and modalities that focus on specific demand issues may be a more appropriate alternative, e.g. a brief five-page country partnership note.

## VII. Enhancing IFAD's knowledge products and services

17. IFAD has a wide variety of knowledge products, largely based on the projects it supports, that provide a source of learning for the country concerned, IFAD staff and potentially other countries. This is supported and enhanced by the use of IFAD grant financing to selectively promote capacity-building and knowledge creation and transfer within countries, as well as knowledge transfer across countries. The country-level knowledge base also includes COSOPs, which are primarily intended to develop a consensus (and country ownership) around the strategic approach to be followed and how IFAD lending will support that approach. Their starting point is a descriptive overview of rural poverty in the country, and they also contain detailed analysis of in-country institutional capacity that can serve as a basis for policy dialogue.
18. This country-level programmatic knowledge base is further supported by a limited number of free-standing analytical studies (such as two recent regional reviews of rural poverty carried out jointly with the Food and Agriculture Organization of the United Nations [FAO]), conferences and regional knowledge-sharing events used specifically to disseminate particular knowledge products. Increasingly important, IFAD has sponsored regional networks (e.g. Knowledge Networking for Rural Development in Asia/Pacific Region [ENRAP] and FIDAMERICA) to link its projects at the regional level and allow for cross-regional learning by participating staff and others. Finally, IFAD's Office of Evaluation produces selective evaluations at country and project level, from both an accountability and a learning perspective, and these form part of a broader annual assessment of IFAD's effectiveness in the form of the ARRI. These products add up to a potential knowledge content that has not yet been formally structured around what IFAD's MIC borrowers are looking for and, subsequently, how to effectively transfer it from IFAD to MICs and, with both IFAD and MIC support, across countries.
19. **IFAD Strategy for Knowledge Management.** The strategy proposes a comprehensive agenda for improving IFAD's learning from development practice so that it increasingly becomes a knowledge-based organization. It encompasses a clear set of objectives and a broad-gauged approach to achieving them, through an identification of core knowledge themes, the instruments needed for improved learning and knowledge-sharing at the country level, the cultural and behavioural changes needed for implementation, and the integration of the approach into a cost-effective results framework. Based on its findings and recommendations, the strategy's implementation is to pay particular attention to a number of areas for strengthening IFAD's knowledge management to benefit MICs:
- (a) **Deepening the knowledge IFAD captures from its projects.** IFAD devotes a great deal of time and effort to assessing whether its projects and programmes have yielded the expected results. Its project completion reports

are in-house products that serve the project authorities and IFAD managers concerned.<sup>11</sup> As in other IFIs, such reports rarely resonate beyond this limited audience. IFAD also undertakes country programme evaluations and selective in-depth project evaluations. These are extensive exercises, with teams of consultants spending considerable time in the country and with highly developed methodologies and data requirements. There are invariably workshops – in-country and within IFAD – to discuss conclusions and recommendations, which inform the ARRI produced by the Office of Evaluation. These are a source of learning for the managers concerned and the scope remains for a wider institutional audience. Greater emphasis could be placed on thematic evaluations (such as the thematic evaluation on IFAD’s experience with rural finance) that draw on IFAD’s project completion reports and country studies, and provide guidance to borrowing countries and IFAD staff on approaches to be adopted in areas such as water management and indigenous populations.

- (b) **Increasing IFAD’s country presence so as to deepen its country knowledge for enhanced programme design and supervision.** As part of its phased introduction of country presence, IFAD has appointed country presence officers in two MICs, China and Egypt. In both cases, these officers are considered to have made important contributions to a better dialogue, improved country knowledge and more effective capacity-building, and to have laid the groundwork for further knowledge exchange and use.
- (c) **IFAD should deepen its intra-institutional knowledge sharing.** IFAD needs to focus much more on how to disseminate best practices institution-wide, e.g. IFAD could institute a learning week along the lines of the sector weeks in the World Bank. This would also facilitate and make greater use of partnering with other IFIs to mainstream or replicate such approaches in MICs. Regional directors could be specifically charged with intraregional and cross-regional knowledge sharing as part of their accountabilities.
- (d) **Selective use of grants to promote capacity-building in middle-income countries and knowledge brokering among developing countries, particularly between middle-income and low-income countries.** During the three-year Seventh Replenishment period, IFAD provided about US\$4.5 million of grants to 13 MICs. In most cases, the purpose of the grants was capacity development, in line with the practice of other IFIs and bilateral donors. While some of these grants went to governments, some went to partner organizations (two to FAO and one to the United Nations Development Programme) for country-based work. In select instances (see box 4), these grants play an important role in IFAD’s knowledge management.
- (e) **Expanding IFAD’s role as a knowledge broker, helping middle-income countries to bring their own knowledge to other middle-income or low-income countries.** There is a great deal of interest among many of the larger MICs, such as Brazil, China, South Africa and Thailand, in making their knowledge more broadly available. There is strong support among country programme managers for IFAD to play a much larger role in brokering this process of South-South knowledge transfer on rural poverty issues.
- (f) **IFAD should make greater use of partnering with other IFIs to mainstream or replicate approaches in MICs.** IFAD should enter into partnerships with other IFIs to scale up successful approaches tested under IFAD projects. This would “enhance operational effectiveness” as highlighted

<sup>11</sup> A recent initiative in El Salvador piloted a participatory project closing workshop as part of project completion report preparation. At this event, beneficiaries, farmers’ organizations, NGOs, government, donors and private-sector representatives came together with communities’ representatives to share knowledge about the experience and identify ways to continue supporting the communities after project closing. This was viewed by all as a very positive experience and could be considered as an integral part of the project process to enhance client feedback and sustainability.

in the paper on Collaboration and Partnerships for Increased Impact and Effectiveness (REPL.VIII/4/R.9). IFAD's project completion reports on successful programmes or components should explicitly discuss their readiness for scaling up and related options.

**Box 4: IFAD's role in knowledge brokering in Thailand**

IFAD has used its capacity to provide financial assistance through small grants in maintaining links with Thailand and helping Thailand's Ministry of Agriculture develop its own capacity and provide support to weaker administrations in other Asian countries. A grant to the Ministry is helping it strengthen monitoring and evaluation through training events, and then using its officials to support supervision and other activities in some of the neighbouring countries. Two regional grants are also providing important support for Thailand's interest in transferring its own knowledge to other countries. One is work on biofuels cofinanced with the Asian Development Bank – in Cambodia, China, Lao People's Democratic Republic, Myanmar, Thailand and Viet Nam. Case studies were recently presented and discussed in Manila. The second is a grant for the Programme for Enhancing the Agricultural Competitiveness of Rural Households in the Greater Mekong Subregion. While this is not perceived either by IFAD or the Thai Government as constituting a full-fledged programme, there is scope for building this into a more formal partnership along the lines of the knowledge partnerships that Thailand has entered into with the World Bank.

## VIII. Enhancing IFAD's role in innovation

20. Innovation is another area in which IFAD can add value to its involvement with MICs. Two key issues provide the parameters for IFAD's role. First, a number of MIC governments have indicated that they appreciate IFAD's capacity and willingness to engage in small pilot and innovative loan/grant programmes, often not yet taken up by at the government level. Second, innovation needs to be seen as the central component of IFAD's involvement in MICs, since these countries have been a birthplace for innovative approaches that can and should be applied to low-income countries and fragile States.
21. Governments look to IFAD to demonstrate the viability of these programmes and, if appropriate, to advise and assist them on scaling up. Innovation usually begins with the activities of individuals, NGOs or local government bodies. IFAD can assist in the field trials through its grant programme or through a small loan component where, subsequently, the activity usually expands into an area-based programme that IFAD can support through its normal lending programme. Nevertheless, IFAD must be careful to limit those financing activities in MICs that only support the expansion of well established national programmes, and must apply the value-added test to its lending to MICs to ensure that it adds a strategy, policy or knowledge dimension to the programmes it supports. For example, joining a sector-based programme, as advocated by the Accra Agenda for Action, may be important in giving IFAD a seat at the table and enabling it to serve as a voice for the rural poor and an instrument for steering programmes in the direction of supporting them.
22. IFAD needs to find ways to partner with governments and other agencies in replicating successful innovation. IFAD needs to see itself as an advocate for successful innovations and may need to channel its own resources into mainstreaming important innovations, recognizing the role of partner institutions in taking the leadership as the activity expands and is replicated.
23. The transfer of knowledge on successful innovation across countries is another important challenge. IFAD needs to do the best possible job of making success stories widely known within the institution and accessible to borrower countries and other agencies. This capture of experience needs to be written into the job description for country programme managers and their managers.

## **IX. The way forward: key actions**

### 24. IFAD will:

- Consider a wider choice of IFAD financing terms for MICs, e.g. with regard to the lending period and grace period.
- Review its internal loan processing procedures with a view to streamlining IFAD procedures for developing new country strategies and projects in MICs that have a strong track record of success in implementing IFAD-supported projects and programmes.
- Explore a wider variety of IFAD instruments than just sovereign lending and grants.
- Review modalities to enable those countries that may decide to cease borrowing from IFAD to continue to access IFAD's technical expertise.
- Consider developing transparent criteria (drawing on those used by the World Bank) to open a dialogue between IFAD and the Member State about its continuing need to borrow from IFAD.
- Continue to implement the Knowledge Management Strategy in MICs, and pursue more active promotion of South-South cooperation, which will include supporting MICs in their efforts to promote knowledge sharing and innovation in low-income countries.
- Prepare a paper for consideration by the Executive Board by December 2009 on the issues raised in paragraphs 24 to 29.